



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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| Date Amended: | 3/07/01 | Bill No: | AB 19x |
| Tax: | Sales and Use | Author: | Briggs |
| Board Position: | Neutral | Related Bills: | AB 37 (Strickland) AB 1636 (Briggs) SB 835 (Battin) |

BILL SUMMARY

This bill would provide a partial sales and use tax exemption for sales of diesel fuel used in farming activities for the period of July 1, 2001 through December 31, 2001.

ANALYSIS

Current Law

Existing law imposes a sales or use tax on the gross receipts from the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of diesel fuel are subject to sales or use tax.

Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that is left on board after the water common carrier reaches its first out-of-state destination. With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight.

Current law provides that the sales tax revenue from the sale of diesel fuel is allocated on a quarterly basis to the Public Transportation Account. The money transferred to the Public Transportation Account is generally used to fund public transit projects.

Proposed Law

This bill would add Section 6357.1 to the Revenue and Taxation Code to provide on or after July 1, 2001 and before January 1, 2002, a 4.75 percent sales and use tax exemption for the sale in this state of, and the storage, use or other consumption in this state of, diesel fuel used in farming activities. This bill would define "farming activities" to have the same meaning as "farming business" as set forth in Section 263A of the Internal Revenue Code. "Farming activities" would also include the transportation and delivery of farming supplies to farmers and the transportation and delivery of farm products to the marketplace.

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The proposed exemption would not apply to the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or the taxes imposed under Section 6051.2 or 6201.2, or under Section 35 of Article XIII of the California Constitution.

The provisions of the bill would become operative immediately.

Background

Three bills were introduced last year to provide varying exemptions for sales of gasoline and diesel fuel. Assembly Bill 1706 (Strickland, et al.) would have provided a sales and use tax exemption for sales of gasoline and diesel fuel. AB 1706 was amended in the Assembly Revenue and Taxation Committee to remove the tax exemption language from the bill. Assembly Bill 43 (Villaraigosa) would have provided a 5 percent state sales and use tax exemption for sales of gasoline and diesel fuel for the period June 1, 2000 through September 30, 2000. AB 43 was never heard in a policy committee. Senate Bill 1777 (Burton) would have provided a 5 percent state sales and use tax exemption for sales of gasoline and diesel fuel, and also would have created a Petroleum Windfall Profits Tax that would have been imposed on refineries for failing to pass on the tax exemption savings to consumers. SB 1777 was never heard in a policy committee. The Board was *neutral* on AB 1706, *neutral, point out problems* on AB 43 and voted to *support* SB 1777.

COMMENTS

- 1. Sponsor and Purpose.** According to Assembly Member Briggs' office, who is also the sponsor of the bill, the purpose of this bill is to reduce the price of diesel fuel to help alleviate price spikes on diesel fuel and also to help reduce the cost of producing power by diesel powered generators.
- 2. Summary of amendments.** The previous version of this bill provided a partial tax exemption for the sale of diesel fuel from the operative date of the bill through August 31, 2001. The amendments to this bill would result in the exemption period lasting from July 1, 2001 through December 31, 2001. Additionally, the exemption would only apply to sales of diesel fuel for use in farming activities.
- 3. Definition of farming activities.** The proposed exemption would apply to sales of diesel fuel used in farming activities. This bill provides that "farming activities" is defined to have the same meaning as "farming business" as set forth in Section 263A of the Internal Revenue Code (IRC). IRC 263A provides for the capitalization and inclusion of inventory costs of certain expenses. This section refers to items produced by a taxpayer in a farming business, such as any animal, or any plant which has a preproductive period of 2 years or less. The bill also provides that the definition of "farming activities" includes the transportation and delivery of farming supplies to farmers and the transportation and delivery of farm products to the marketplace.
- 4. Transportation funding would be reduced.** Current law provides that the sales tax revenue on sales of diesel fuel be transferred to the Public Transportation Account. The revenue transferred to this fund is used to pay for various mass

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transit projects in the state. Creating an exemption for sales of diesel fuel would eliminate a portion of the revenues that would normally be appropriated to the Public Transportation Account.

5. **Proposed exemption could be difficult for retailers to administer.** The proposed exemption for sales of diesel fuel would apply only to sales of diesel fuel used in farming activities. The definition of farming activities would include the transportation of farming supplies to farmers and also the transportation of farm products to the marketplace. Retailers would be required to obtain and retain documentary evidence supporting any claimed exempt sales. This would require a trucker to provide documentary evidence to the fuel retailer about the type of product they are transporting and where they are transporting it in order to support the exemption. This would be very difficult since truckers often purchase diesel fuel from card-lock locations where there is no attendant to adjust the price of diesel at the pump for the exemption or obtain documentary evidence from the purchaser to support the exemption.
6. **Proposed exemption would become operative immediately.** The proposed exemption would become operative immediately, but the language provides that the proposed exemption would apply on or after July 1, 2001. If the bill were to become law on or after July 1, 2001, the Board would not have an opportunity to notify affected retailers and consumers of the law change prior to the new law taking effect.
7. **Partial tax exemptions are difficult to administer.** Due to the method used to report partial tax exemptions, any return containing a claimed partial tax exemption must be processed manually for the proper allocation of local taxes. Current law provides for two partial tax exemptions. The current partial tax exemptions apply to sales of manufacturing equipment and teleproduction equipment. The number of returns affected by the current partial tax exemptions are relatively minor. However, this bill would cause a significant increase in the number of returns filed containing a partial tax exemption. Additionally, diesel fuel is generally sold at the pump for a tax included price. Since the proposed exemption would only apply to some sales of diesel fuel, retailers may incur difficulties adjusting the sales price for exempt sales of diesel fuel.
8. **Interstate users of diesel would continue to pay an amount equivalent to the sales tax.** Pursuant to Sections 60115 and 60116 of the Diesel Fuel Tax Law, interstate users must pay an excise tax on each gallon of diesel fuel used in this state at a tax rate of 18 cents per gallon plus an amount equivalent to the rate of sales tax imposed on diesel fuel purchased in this state. Interstate users can subsequently claim a credit for the total amount of the tax on each gallon used outside California provided they actually paid the tax to an in-state retailer. These provisions in the law were added by AB 1269 (Ch. 618, 1997) in order to eliminate the incentive for an interstate user to tank up outside California. Without conforming amendments to Sections 60115 and 60116, interstate users would still be required to pay the equivalent sales tax component on their use of diesel fuel in this state, provided this bill were enacted.

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- 9. Related Legislation.** AB 37(Strickland) would provide a permanent exemption from the sales and use tax for diesel fuel and gasoline. AB 1636 (Briggs) would provide a sales and use tax exemption for sales of diesel fuel. SB 835 (Battin) would provide a sales and use tax exemption for the state and federal excise tax imposed on gasoline or diesel fuel. The Board took a neutral position on AB 37, AB 1636 and SB 835.

COST ESTIMATE

Some additional administrative workload would be realized as a result of notifying affected retailers and responding to inquiries. Due to the partial tax exemption, additional resources will be needed to process returns in order to ensure the proper allocation and payment of local and district taxes. A detailed cost estimate of the workload impact is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The average retail price (less sales tax and state excise tax) of diesel fuel in California during the third quarter of 2000 was \$1.4833 per gallon. According to the U.S. Energy Information Administration (EIA), consumption of diesel fuel for farming activities in California amounted to 220.5 million gallons in 1999. Estimated gallonage used during the six-month period from July through December was 113 million. Total sales of diesel fuel used during this period are estimated to be \$167.6 million. (113 million gallons x \$1.4833 per gallon = \$167.6 million.)

This proposal would include within the definition of farming activities the transportation and delivery of farming supplies to farmers and the transportation and delivery of farm products to the marketplace. According to the U.S. Census Bureau's 1997 Economic Census of Transportation and Warehousing, revenues for those firms engaged in the transportation of agricultural products accounted for 3.35% of the total trucking industry revenue in California. If we apply this percentage to the total gallons of diesel used annually on-highway in California – 2.4 billion gallons – estimated gallons used in transporting agricultural products would amount to 80.4 million gallons. (2.4 billion gallons x .0335 = 80.4 million gallons.) At an average price of \$1.4833 per gallon, annual sales amount to \$119.3 million. (80.4 million gallons x \$1.4833 = \$119.3 million.) The estimated sales for the six-month period of this exemption would be \$59.7 million.

Total sales that would be exempted by this proposal are estimated to be \$227.3 million. (\$167.6 million + \$59.7 million = \$227.3million.)

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Revenue Summary

The revenue loss from exempting diesel fuel used in farming activities from the 4.75% state sales and use tax for the period July 1, 2001 until December 31, 2001 would be \$10.8 million.

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